

Message Text

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ACTION EA-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01

INR-07 NSAE-00 USIA-15 TRSE-00 XMB-04 OPIC-06

SP-02 LAB-04 SIL-01 OMB-01 STR-05 DODE-00 PA-02

PRS-01 AGRE-00 /075 W

-----129309 081045Z /11

R 080759Z NOV 77

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 7455

INFO AMCONSUL HONG KONG

UNCLAS SECTION 1 OF 2 SEOUL 9434/1

HONG KONG FOR REGFINATT

E.O. 11652: N/A

TAGS: BEXP, ETRD, EFIN, KS

SUBJ: KOREAN GOVERNMENT CLAMPS DOWN FURTHER ON INFLOW OF FOREIGN
CURRENCY LOANS

SUMMARY: IN AN EFFORT TO CUT DOWN ON INFLATIONARY INFLOW OF
FOREIGN EXCHANGE, KOREAN GOVT HAS ABOLISHED SO-CALLED TYPE-III
FOREIGN CURRENCY LOANS, WHICH HAVE BEEN USED TO FINANCE IMPORTS
OF CERTAIN ESSENTIAL RAW MATERIALS. MECHANISM HAS BEEN SET
UP TO ENSURE THAT SUCH IMPORTS WILL IN FUTUER BE FUNDED FROM
FOREIGN EXCHANGE RESERVES ALREADY HELD IN-COUNTRY. THIS
MEASURE WILL TAKE SOME LENDING BUSINESS AWAY FROM FOREIGN
BRANCH BANKS IN KOREA, AND WILL MAKE IT MORE EXPENSIVE FOR
KOREAN IMPORTERS TO FINANCE PURCHASES OF RAW MATERIALS.
GENERALLY, HOWEVER, IT IS REGARDED AS A SENSIBLE SHORT-TERM
MEASURE TO COUNTER EXCESSIVE FOREIGN EXCHANGE INFLOWS.
END SUMMARY.

1. KOREA'S STRONG EXPORT PERFORMANCE THIS YEAR -- MOST
NOTABLY IN THE SERVICES SECTOR, THANKS TO MIDDLE EASTERN
CONSTRUCTION CONTRACTS --HAS HAD THE UNFORTUNATE EFFECT
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OF SWELLING KOREAN FOREIGN EXCHANGE RESERVES TO THE
POINT OF DANGEROUSLY EXACERBATING DOMESTIC INFLATIONARY
PRESSURES. IN AN ATTEMPT TO CORRECT THE SITUATION, THE
KOREAN GOVERNMENT --MAKING USE OF ELABORATE ECONOMIC
CONTROL APPARATUS AT ITS DISPOSAL --HAS MADE A RAPID
SUCCESSION OF SMALL ADJUSTMENTS, OVER PAST FEW MONTHS,
AIMED AT SLOWING DOWN INFLOW OF FOREIGN CURRENCY.

2. PERHAPS THE BOLDEST SINGLE MEASURE IN THE CURRENT SERIES WAS TAKEN EFFECTIVE NOVEMBER 1, AND AIMS ESSENTIALLY AT ENSURING THAT IMPORTS OF ESSENTIAL RAW MATERIALS ARE FINANCED BY FOREIGN EXCHANGE RESERVES ALREADY EXISTING IN-COUNTRY RATHER THAN BY NEW FX INFLOWS. UNDER NEW BANK OF KOREA REGULATIONS, SO CALLED TYPE-III FOREIGN CURRENCY LOANS -- FX LOANS AVAILABLE TO IMPORTERS FOR PURCHASE OF DEFENSE RAW MATERIALS, RAW COTTON, AND CERTAIN RAW MATERIALS DESTINED FOR EXPORT INDUSTRIES -- HAVE BEEN ABOLISHED. SUCH LOANS, EXTENDED BY FOREIGN BRANCH BANKS, HAD THE ADVANTAGE OF BEING RELATIVELY CHEAP FOR THE IMPORTER (SIX-MONTH LIBOR PLUS 1.25 PERCENT), BUT ALSO THE DISADVANTAGE, FROM GOV'T'S VIEWPOINT, OF REPRESENTING AN FX INFLOW FOR THE ECONOMY.

3. IN THE PLACE OF TYPE-III LOANS, IMPORTERS MAY NOW MAKE USE OF TWO NEW LENDING FACILITIES: (A) LOCAL (WON) CURRENCY LOANS, COVERING UP TO 70 PERCENT OF EACH PURCHASE, AVAILABLE ON SIX-MONTH TERMS AT 15-16 PERCENT INTEREST; AND (B) SO-CALLED SPECIAL FOREIGN CURRENCY LOANS, COVERING UP TO 90 PERCENT OF THE PURCHASE, AVAILABLE ON MORE FAVORABLE TERMS (ONE YEAR MATURITY, LIBOR PLUS 1.25 PERCENT), BUT LIMITED IN APPLICATION TO IMPORTS OF RAW COTTON AND QUOTE ITEMS DESIGNATED BY FINANCE MINISTER UNQUOTE. IMPORTS OF RAW COTTON UNDER UNCLASSIFIED

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THIS SPECIAL FX FINANCING FACILITY WILL BE PERMITTED UNTIL THE OUTSTANDING LOAN BALANCE FOR COTTON PURCHASES REACHES \$120 MILLION. IN THE CASE OF THE WON LOANS, CONVERTIBILITY WOULD BE ASSURED FOR FOREIGN SUPPLIER, FROM FX FUNDS HELD BY LOCAL FOREIGN EXCHANGE BANKS.

4. COMMENT: ASIDE FROM CUTTING DOWN ON INFLOW OF FOREIGN EXCHANGE, ELIMINATION OF TYPE-III FOREIGN CURRENCY LOANS WILL HAVE AN IMPACT ON THE OPERATIONS OF FOREIGN BRANCH BANKS AND CERTAIN KOREAN IMPORTERS: SNEIDER

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ACTION EA-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01

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SP-02 LAB-04 SIL-01 OMB-01 STR-05 DODE-00 PA-02

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FM AMEMBASSY SEOUL

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INFO AMCONSUL HONG KONG

UNCLAS SECTION 2 OF 2 SEOUL 9434/2

HONG KONG FOR REGFINATT

(A) IN THE CASE OF FOREIGN BRANCH BANKS, THE MEASURE REMOVES ONE FAIRLY IMPORTANT MONEY-MAKER FROM THEIR ARSENAL OF LENDING TOOLS (THOSE REMAINING ARE: PROJECT LOANS CHanneled THROUGH ECONOMIC PLANNING BOARD UNDER FOREIGN CAPITAL INDUCEMENT LAW; WON LOANS FROM FUNDS MADE AVAILABLE UNDER SWAP ARRANGEMENTS; SO-CALLED TYPE-II LOANS, USED MAINLY TO FINANCE IMPORTED CAPITAL EQUIPMENT; AND SHORT-TERM TRADE CREDITS). FOREIGN BRANCH BANKS WILL NOT RPT NOT BE AUTHORIZED TO EXTEND THE "SPECIAL" FOREIGN CURRENCY LOANS, AND THEIR ABILITY TO ENGAGE IN WON LENDING IS LIMITED BY STRICTLY CONTROLLED CEILINGS ON "SWAP ARRANGEMENTS" WITH BANK OF KOREA, WHEREBY BRANCH BANKS OBTAIN WON FOR LENDING PURPOSES. LOCAL FOREIGN BANKERS NOTE WRYLY THAT LATEST ROKG MEASURE IS BUT "ONE MORE TURN OF THE SCREW" ON THEIR ACTIVITIES HERE. THEY CONCEDE, HOWEVER, THAT IT MAKES ECONOMIC SENSE AND DO NOT BELIEVE THAT GOV'T WIL ALLOW VARIOUS RESTRICTIONS TO REACH POINT WHERE BRANCH BANK ACTIVITIES IN KOREA BECOME UNPROFITABLE. N.B. OUTSTANDING BALANCE OF ALL TYPE-III LOANS AS OF SEPTEMBER 30, 1977 WAS \$59.5 MILLION.

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(B) ELIMINATION OF TYPE-III LOANS WILL HURT IMPORTERS OF RAW MATERIALS IN THAT WON CURRENCY FINANCING, AT 15-16 PERCENT, IS MORE EXPENSIVE THAN FOREIGN CURRENCY FINANCING AT LIBOR PLUS 1.25 PERCENT (LIBOR HAS AVERAGED ROUGHLY 7 PERCENT). ASIDE FROM RAW COTTON AND DEFENSE RAW MATERIALS, EDESIGNATED ITEMS AFFECTED -- THOSE PREVIOUSLY ELIGIBLE FOR TYPE-III LOANS -- INCLUDE IRON AND STEEL ORE, COPPER ORE, PHOSPHATE ORE, SCRAP IRON, BEEF TALLOW, WHEAT, CORN, POLYPROPYLENE, SHIPS FOR

BREAKING-UP, ETC. ONE UNDERLYING PURPOSE OF THE TYPE-III LOAN FACILITY HAD BEEN TO ALLOW KOREAN IMPORTERS TO BUY ABOVE COMMODITIES IN LARGE AMOUNTS WHEN WORLD PRICES WERE MOST FAVORABLE. TO EXTENT THAT HIGHER FINANCING COSTS NOW ELIMINATE THIS PRICE ADVANTAGE, IMPORTS OF THESE ITEMS MAY BE CUT DOWN SOMEWHAT. BY THE SAME TOKEN, HIGHER COST OF LOANS WILL ENCOURAGE KOREAN BUYERS TO IMPORT MORE ON A SIGHT -- RATHER THAN DEFERRED-PAYMENT -- BASIS, WHICH SHOULD INCREASE THE OUTFLOW OF FOREIGN EXCHANGE FOR A TIME.

(C) RAW COTTON IMPORTS CONSTITUTE A SPECIAL CASE AS THEY WILL BE ELIGIBLE FOR FUNDING, UP TO LIMIT OF \$120 MILLION, UNDER SPECIAL FOREIGN CURRENCY LENDING FACILITY. IMPACT OF NEW MEASURE, ACCORDING TO LOCAL INDUSTRY REPS, WILL NOT BE FELT UNTIL IMPORTS REACH \$120 MILLION. AT PRESENT, HOWEVER, OUTSTANDING CONTRACTS HAVE REACHED \$320 MILLION; OF THAT AMOUNT, \$120 MILLION CAN BE FINANCED UNDER THE SPECIAL FOREIGN CURRENCY LOAN ARRANGEMENT AND \$100 MILLION UNDER REMAINING CCC CREDITS. THE REMAINING \$100 MILLION WILL THEREFORE EVENTUALLY HAVE TO BE FUNDED UNDER THE MORE EXPENSIVE WON LENDING FACILITY. END COMMENT.

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5. ABOVE ROKG EMEASURE TO CURTAIL FOREIGN EXCHANGE INFLUX HAS BEEN ANALYSED IN SOME DETAIL BECAUSE OF ITS DEFIN-ABLE IMPACT ON U.S. BANKS AND U.S. EXPORTERS OF RAW MATERIALS. CONCISE SUMMARY OF OTHER RECENT MEASURES WILL BE PROVIDED BY SEPTTEL.
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Message Attributes

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Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
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Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment:
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Disposition Event:
Disposition History: n/a
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Disposition Remarks:
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Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
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Handling Restrictions: n/a
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